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The Province of Alberta

IN THE MATTER OF "THE NATURAL GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into Scheme to be adopted for Gathering, Processing and Transmission of Natural Gas in Turner Valley

G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta October 11th, 1945

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I N D E X

VOLUME 48

October 11th, 1945,

W I T N E S S E S

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THE NATURAL GAS UTILITIES BOARD

PROVINCE OF ALBERTA

IN THE MATTER OF an Inquiry being conducted by the Natural Gas Utilities Board under the provisions of The Natural Gas Utilities Act.

Prior to the commencement of the Hearing currently being conducted by the Natural Gas Utilities Board, a tentative agenda was prepared in consultation with all Counsel appearing. It is not suggested that the subjects set down in the agenda were intended to be exclusive of any other relevant subjects, but rather the agenda was prepared so that there might be some semblance of order in the conduct of the proceedings.

On first October, Mr. McDonald, acting on behalf of a majority of Natural Gas Producers in Turner Valley, made an application to the Board for an Order that there be added to the Agenda, the following matters for consideration and determination.

1. The price to be paid for gas at the point such gas enters the distributing system of any municipality.
2. The price to be paid for gas at the point such gas enters the Plant of the Alberta Nitrogen Products Limited.

OR ALTERNATIVELY

1. The rate to be paid to or charged in its internal accounts by the Canadian Western Natural Gas, Light, Heat and Power Company Limited, in respect to the services rendered by it in transmitting gas from the Madison Scrubbing Plant to:

(a) The Plant of the Alberta Nitrogen Products Limited.

(b) The point of delivery of gas to the distributing system in the City of Calgary.

(c) The points at which gas is delivered to the distributing system of other municipalities served by the transmitting lines.

(d) The point at which gas is delivered to the Compressor Station at Bow Island, and including cost of compressor services.

He contends that such an Inquiry is within the Board's jurisdiction and refers to Section 72 (f) of The Natural Gas Utilities Act, which gives the Board power to fix "the just and reasonable prices to be paid for all services over which the Board has jurisdiction."

He contends it will be necessary for the Board in determining a just and reasonable well head price to establish a transportation rate applicable to all the main transmission lines of The Canadian Western Natural Gas, Light, Heat & Power Company (hereinafter called "The Gas Company") and in particular a transportation rate for gas which is sold by the Gas Company to Alberta Nitrogen Products Limited. Mr. Steer, for the Gas Company, contends that the Board has no jurisdiction to fix such transportation rates and that so far as its common carrier activities are concerned, the Gas Company is under the jurisdiction of The Public Utilities Board and under that Board alone. He contends that Section 72 (f) quoted above must be read in conjunction with The Pipe Line Regulation Act, and that when so read this Board has no jurisdiction over main line transportation rates.

Mr. Steer also filed two affidavits, one by Frederick A. Smith, Controller and Chief Accountant of the Gas Company, the effect of which is:

(a) that the Company's books are kept under a plan laid down by the National Association of Railroad and Utilities Commissions, or under a plan laid down by The Pennsylvania Public Services Commission, and that as a result the books would not afford information from which the costs of any one operation carried on by the Company could be ascertained; and

(b) that the Company's operations are carried on as a unit and that the prices for gas sold are the same at all points on the Company's distribution system.

Mr. Smith was cross-examined on this Affidavit but little information of assistance was elicited. The Board believes that since the Company's books are kept on a system applicable to unit operation an examination of them would not afford information from which main line transmission rates could be determined. Nevertheless if Mr. McDonald is right and if this Board has jurisdiction to enlarge the scope of the present Inquiry to include transportation rates book information is unimportant and it will be necessary for the Company to sever its transmission system from its distribution system; it will be necessary for this Board to fix a rate base and determine the operating costs, depreciation rates and the rate of return for the transmission division, and The Public Utilities Board will require to do the same thing for the distribution system. On the fixing of such rate bases and allied matters reference might then be made to the Company's books in order to test the estimates submitted by the Gas Company when the severance of the two operations takes place.

Mr. Frank A. Brownie, assistant to the Managing

Director of the Gas Company, filed an affidavit and was cross-examined thereon. There was exhibited a map showing the Gas Company's main transmission lines. They extend from Foremost to Bow Island and from Bow Island to Calgary, and there are three lines from Turner Valley connected to the main Bow Island-Calgary line. Between Foremost and Calgary 13 hamlets, towns and villages, 10 military establishments and the Nitrogen Plant are supplied with gas. The price charged by the Company is uniform in all places served excepting the Nitrogen Plant where the price is 7 cents per MCF and that price is contingent upon Royalite Oil Company Limited selling gas to the Gas Company at a price of 5.4 cents per MCF, leaving the Gas Company with the sum of 1.6 cents per MCF for transporting the gas from Turner Valley to the Plant. This price may be too great or it may not be sufficient and ultimately may affect the well head price.

Before attempting to deal with the problem in issue, some preliminary observations should be made. They do not arise out of the record but are matters of which the Board has knowledge. The City of Edmonton is supplied with gas by the Northwestern Utilities Limited, and that Company owns its own gas resources, produces its own gas and transports it through main transmission lines a distance of approximately 100 miles to Edmonton, at the same time serving communities along the way all at a uniform price - a unit operation. The Wainwright Gas Company owns some wells, buys gas from other companies and transports the gas through main transmission lines to its distribution system in Vermilion. The same applies to companies operating in Vermilion, Brooks, Redcliffe and Tilley. The Valley Gas Company serving Turner Valley

village, hamlets in Turner Valley and many isolated customers has in relation to the number of its consumers extensive main transmission lines. If Mr. McDonald is right each of these companies will require to sever their transportation from their distribution activities.

An examination of the Public Utilities Act being Chapter 28, Revised Statutes of 1942; the Pipe Line Act being Chapter 315, Revised Statutes of 1942; The Pipe Line Regulation Act, Chapter 316, Revised Statutes of 1942; The Oil & Gas Fields Public Service Utilities Act, Chapter 259, R. S. A. 1942, and The Natural Gas Utilities Act, discloses a confusion of jurisdiction which in the Board's humble opinion can only be clarified by legislative action. The Board is in doubt as to the intent of the Legislature and in particular is in doubt as to whether or not it intended to oust the rate making jurisdiction of The Public Utilities Board over these companies mentioned, with respect to main transmission lines but it seems to the Board from the language used that that is exactly what the Legislature has done.

This Board is given exclusive power and jurisdiction to deal with all public utilities as defined in the Act. It is provided by Section 68 that subject to the further provisions of the Act every pipe line shall be a public utility.

"Pipe line" is defined as:

> ".....including any pipe line used for the transporting of gas from any field or area where such gas is produced to or through any municipality, but excluding any distribution system used for the distribution of any such gas to the consumers in any such municipality....."

The rate making powers of The Public Utilities Board as to distribution systems are preserved by the provisions of Section 50, Subsection (2) of The Natural Gas Utilities Act, but it seems to the Board that notwithstanding the confusion of jurisdiction and notwithstanding all the provisions of all the Acts referred to, that it has had conferred upon it the specific and particular jurisdiction now in issue and has thereby restricted or modified the general powers conferred upon the Public Utilities Board by other Statutes with respect to main transmission lines. Whether this is desirable or not does not affect the problem.

As originally enacted, Section 72 was mandatory. By the amendment of 1945 the Board's powers became permissive unless otherwise directed by the Lieutenant Governor in Council. The Board considers that it cannot exercise properly the discretionary powers given to it by this Section without making inquiry into every relevant factor which goes to the fixing of the many just and reasonable prices which it must fix. As already indicated the Board believes that main line transportation rates are relevant to many of the issues involved. It will, therefore, order that the fixing of the transportation rates through the main transportation lines of the Gas Company as set out in the application form a branch of the present Inquiry and that the Gas Company furnish the Board at an appropriate time during the hearing with such evidence in that regard as will enable the Board to discharge properly all its responsibilities under the Act.

G. M. BLACKSTOCK

CHAIRMAN

October 10th, 1945.

THE CHAIRMAN: Before you start, Mr. Blanchard, we want you to know that we have arrived at a decision on Mr. McDonald's motion. The decision is that the motion should be granted. The text of the decision will be in today's transcript. Mr. Steer and Mr. McDonald who are perhaps both vitally interested have been given copies this morning. That is the decision and if Mr. Steer wishes to take an appeal from that decision, since we will not be meeting again until the 5th of November, the decision will also be accompanied by a stay or a suspension of the Order until such time as the appeal, if there is one, can be heard and disposed of.

MR. STEER: I have no doubt that an appeal will be launched.

MR. BLANCHARD: Before we start, I would like to speak to the agenda for the week of the 5th of November. Mr. Hamilton might be otherwise engaged in the City of Edmonton, performing some civic duties as Mayor apparent of the city and it will be inconvenient for him to be here. Mr. McDonald suggested he might have a witness ready to be called for that week and I think it might be well to discuss it.

THE CHAIRMAN: We possibly could arrange to have Professor Stewart available for that week too.

MR. BLANCHARD: Yes. I would doubt if his evidence would take three days.

THE CHAIRMAN: Oh no.

MR. BLANCHARD: Possibly a day at the very most.

THE CHAIRMAN: Yes. You think you might possibly be able to arrange to have some evidence that week, Mr. McDonald?

MR. McDONALD: I feel, sir, acting for the producers,

that I have been pushed around quite a bit at this inquiry.

THE CHAIRMAN: By whom?

MR. McDONALD: Not by anybody but by circumstances, sir. I was hoping that some of the evidence that is contained in Mr. Hamilton's submission would be in. I really hoped it would be and then that I would -ntinue. On the 5th of November, finish with Mr. Hamilton and proceed with my witnesses. It just means further delay. It means making my submission and then if Mr. Hamilton is not finished we will have to pick that up again. Heaven knows whether they will be finished with their evidence before the 1st of January. I am quite sympathetic with Mr. Hamilton's necessity of being in Edmonton for part of the week at least but I would like very much to keep the agenda going as we now have it.

MR. HARVIE: Mr. Chairman, I just cannot say definitely now but it may be that we could fill in one day with a witness during that period. I will endeavour to arrange things if I can to help.

MR. CHAMBERS: I was wondering if we could shorten it by sitting one whole day at least that week in order to meet Mr. Hamilton's convenience.

THE CHAIRMAN: When must you be away from Calgary to become the Mayor apparent of Edmonton?

MR. HAMILTON: I think it will be definitely Wednesday of that week, sir.

THE CHAIRMAN: Well let us talk about it bluntly. When is election day?

MR. HAMILTON: Wednesday, sir.

MR. HARVIE: Do you want Mr. Steer there or not for that day?

THE CHAIRMAN: When do your meetings finish that you pursue the wily electorate?

MR. HAMILTON: I was not concerned with regard to that matter, it was Wednesday more particularly I had in mind.

THE CHAIRMAN: You mean you would be able to go on with your evidence on the 5th and on the 6th?

MR. HAMILTON: I think that would be possible, sir, yes.

THE CHAIRMAN: Supposing there was an acclamation.

MR. HAMILTON: I would still feel obligated to be there on Wednesday.

MR. McDONALD: I was not objecting for a moment.

THE CHAIRMAN: Can we say definitely you can go on on Monday and Tuesday?

MR. HAMILTON: I think so. It is not very convenient but I appreciate the problem it causes for other people and I will do my best to be here for the 5th and the 6th.

MR. BLANCHARD: I do not think you, Mr. Chairman, or myself, when running for public office, ever felt as confident as Mr. Hamilton does. I assume Mr. Hamilton would want to be away before that.

THE CHAIRMAN: Perhaps we did the first time but after that . . . . . Well, we will have to arrange that then, Mr. Hamilton, unless you can arrange it otherwise. We will not require you. We will require you but we will let you go for the 7th.

MR. HAMILTON: Very good, sir.

THE CHAIRMAN: We can arrange for Professor Stewart for the 7th and that would relieve Mr. McDonald of the necessity of leading his case in the way he does not want to lead it.

MR. McDONALD: That will be quite all right. I can have a witness for Wednesday if necessary.

MR. HARVIE: We will have Professor Stewart's submission, I presume, some time before the 7th.

THE CHAIRMAN: That was the intention, Mr. Harvie. We have not had them ourselves yet. All right, Mr. Chambers.

ROBERT WINSLOW HAMILTON, (Continued)

Examined by Mr. Chambers:

Q Mr. Hamilton, on WH 10 of Exhibit 124, I am informed that an amount of $69,957.50 has been deducted from what is included in the historical cost there shown and that that figure of $69,000-odd represents the cost of intangibles in connection with putting in part of the system that was subsequently taken out and put somewhere else. Is that right?

A Yes.

Q Now if we are using the historical cost as the rate base for the gathering system, would you not think that probably that item should be included?

A No sir. I believe the definite distinction must be drawn between assets such as the Seaboard plant, for example, which are functioning and were functioning and in the hands of Royalite even though substantial depreciation might apply thereto, and on the other hand, an asset which does not exist at all, which is the case for the original assets value that lies behind that book figure $69,957.50. This is the shadow, sir, the substance has disappeared.

Q The thought that occurred to me is this, Mr. Hamilton, that you are valuing a gathering system down there and your suggestion is that the historical cost of that system should be

taken rather than the present-day value.

A The historical value of the system as it exists, not as it was at some previous date. For example, let us take an extreme case. Supposing the Royalite Oil Company had been operating a gathering system in Turner Valley for the last 200 years and had invested 50 billions in lines at one time or another, all of which had been removed in substance except for half a million dollars. You can see the extremity to which that would drive us.

Q But here we are talking about a system that has been operating for a period of roughly 20 years, something around that. In the course of constructing that system as it exists today, certain changes have been made, not due to any negligence or misconception of the system at the time and it does occur to me - apparently you disagree with it - that in arriving at the over-all cost of that system that some change in making or re-designing that system , a comparatively small amount, should be included. You disagree with that?

A You put the statement to me I expect and you ask me to presume the propriety of it.

Q Yes. Assuming the facts I have given you are as I have outlined.

A Even so, sir, I think not. The asset does not exist. Therefore it does not satisfy the used and useful rule in any sense whatsoever.

Q I am going to refer again to page 786 of the Canada Year Book, 1943-1944, and I wonder if you would check this. As I understand it, according to the statistics given on that page 786, taking 1926 as the base year for building and

construction materials, do you find that Mr. Hamilton?

A Yes sir.

Q The index figures are as follows and if you will just check this, 1913, 67; 1922, 108.7; 1926, 100; 1929, 99; 1933, 78.3; 1939, 89.7; 1940, 95.6; 1941, 107.3; 1942, 115.2 and 1943, 121.2. Is that correct?

A Yes sir, but you omitted 1920 at which time the index stood at 144.

Q 144 in 1922?

A In 1920. It jumped from 67 in 1913 to 144 in 1920 and then back down to 108.7 in 1922.

Q Yes. Now is this not a fair statement, Mr. Hamilton, that according to the index figures, not those particular ones but index figures generally, that the average value of the dollar over the period from 1921 to 1943 is more than the value of the dollar at March 1944?

A I have not seen the 1944 index, sir, but I will assume that to be so. I do not think there is a 1944 index out. But I just assume it. That is the trend.

Q The trend is not backwards?

A No sir.

(Go to page 3720)

Q And would this also be a fair statement that the average value of the dollar for the period from 1921 to 1940 is more than it was at March 1941?

A Again, sir?

Q I say the average value of the dollar over the period 1921 to 1940 is more than it was as at March 1941?

A I think that is a fair statement.

Q Yes. Now, Mr. Hamilton, as a chartered accountant and in the practice of your profession and as a businessman in the Province, you, I take it, have been aware of the trend and type of social.....

A The last word?

Q The trend and type of social security and labour legislation which has been enacted in Canada in recent years?

A Yes.

Q And you are also aware and have heard about the post-war plan for social security and labour measures which are being suggested?

A Yes.

Q And one of those in recent years is unemployment insurance?

A Yes.

Q And under the scheme of unemployment insurance the employer pays part of the cost?

A Yes.

Q And then there is the Minimum Wage laws that have fixed minimum wages?

A Which have been in force for a good many years.

Q Yes, but they have been, is it not a fact that they have been revamped or brought into general force and effect in comparatively recent years?

A I would not say so, sir. I think they are almost inoperative

today but they were quite a factor as far back as seven or eight or nine years ago.

Q Yes, but is it not so that within the last year, here in Alberta, that minimum wages have been increased under the Act?

A Yes, realistically speaking, but in effect it has not made much difference.

Q A certain amount on account of the war?

A Yes, but the minimum is usually the going rate anyway.

Q And that hours of work legislation came in when, about ten years ago was it not?

A Further back than that, sir.

Q Well, was it put in in 1935?

A It came in under the Farmers' regime.

Q But that hours of work legislation has been overhauled also?

A I think there is a tightening up generally, yes.

Q Shortening the work week, as it were, the standard work week?

A Yes, but mainly with respect to certain special classes of employment, sir, I think that should be noted, namely, with regard to restaurant workers and persons who are not specially able to look after themselves.

Q And then I take it you are aware there is a general move throughout the country on the part of labour to have that week, the standard week, shortened to forty hours?

A The general tendency is to shorten the hours of work, yes.

Q And for any work over that shortened standard week, the question of overtime comes into the picture?

A I would assume so.

Q And then in more recent times there has been a trend of legislation to provide for compulsory holidays with pay?

A Yes.

Q Or vacation with pay?

A Yes.

Q And those are all matters which, when given effect to, cost the employer of labour more dollars and cents?

A More dollars and cents. Whether the real cost is greater is another matter.

Q Yes. Then in connection with this social security legislation there has recently been placed on the Statute books in Canada what is known as the "Family Allowances Act"?

A Yes.

Q Under which the Dominion has undertaken to disburse substantial amounts of money each month to families throughout Canada?

A Yes.

Q My recollection is that that involves approximately two hundred million dollars a year, does it not?

A On that order.

Q Yes. Then as I undestand it in recent years, due not only to legislation but to the general trend that has been formulated in the public minds, there are more pension schemes being set up by companies?

A Yes.

Q In other words, the question of pension schemes in employment has become more or less an accepted fact, or that is not the right word, an accepted usage, let me put it that way?

A Oh, I would not go that far. The tendency is in that direction I guess, whether it is an accepted practice or not is another matter.

Q It is becoming more general anyway?

A It is becoming more general.

Q Yes, and then in connection with labour legislation the matter

of collective bargaining between employees and employers has become compulsory to a large extent, has it not?

A That is the tendency.

Q Yes, and there has been some legislation to that effect?

A Yes.

Q Then the Dominion Government and other Governments, Provincial Governments, have discussed and are making plans for the rehabilitation of those who served in the Armed Forces?

A Yes.

Q And some of those programs which have been talked about are fairly extensive and comprehensive?

A Yes.

Q Well now, what I am getting at is this, would you agree with me that industry in general, manufacturing and so on, will be required in the ordinary course of events to absorb or bear a large part of those costs?

A No, I would agree with you that the average rate of pay per man-hour will increas or has increased substantially over prior periods. What the ultimate incidence of that increased cost per man-hour is , I do not know, but I am fairly satisfied that industry will not bear it.

Q No, but they are paying more dollars, I think you already told me that?

A At the present moment there is more dollars comes out of the Excess Profits tax. You speak of burden, sir, that is why I say that.

Q Well what I am getting at is this, due to the wage situation first of all, overtime and shorter week and higher rates of pay, the payrolls of those, of industry generally, will probably be higher than it otherwise would be?

A The payrolls will be higher, yes, but that does not take into account, of course, the other.....

Q The output?

A The relative efficiency or quality of labour.

Q Yes, but leaving that aside for the moment, the matter of rehabilitation expenses, family allowances, pension schemes and collective bargaining, you will go with me that far, that those will cost industry substantial amounts of money?

A Over a long period of time, Mr. Chambers?

Q Yes?

A Offhand I would think that suggestion is inimitable to the purposes of all the legislation you speak of. The whole purpose of that legislation, as I understand it, is intended to improve the efficiency of labour by increasing the nutrition received by the child on the one hand, the comfort and well-being of workmen, their future security and so forth, all of which has introduced, will introduce a greater output per thousand population.

Q Well now, would you agree with me in this, that all those, that this plan that I have outlined, will involve in the first instance greater amounts paid out by the companies either in taxes or wages, a greater amount paid out by them for taxes and wages?

A No sir, not with regard to taxes, they will pay rather less taxes than they do now, but they will pay it for a different purpose.

Q I am putting this to you, they will be paying greater taxes than they otherwise would have paid if this program had not been inaugurated?

A Other things being equal.

Q Yes?

A Yes, it will involve a greater contribution by industry, yes.

Q Yes?

A Other things being equal.

Q Now you know and I take it, that Canada in general has financed its war expenditures to the extent of about 50% by current taxes, have you heard that?

A Yes.

Q You are aware of that?

A Yes.

Q That is the general report anyway?

A Yes.

Q And that about 50%, about the other 50% has been taken care of by the issue of bonds and War Savings Certificates or by borrowing in some form?

A By borrowing, yes.

Q And that that borrowing has amounted to something of the order of two and a half billion a year?

A Slightly higher than that, I take it. Recently, the average is probably two and a half billion.

Q Throughout the war years?

A Yes.

Q In other words, I am suggesting that the Canadian debt, bonded debt, has risen from around three billion in 1939 to something in the order of eleven or twelve billion now?

A I cannot check your figures.

Q That would be roughly correct, would it not?

A In that direction, yes.

Q Yes, and I suggest to you that the servicing by the Dominion of this increased war debt, would cost something in the neighbourhood of two hundred and fifty to three hundred million

dollars a year?

A I would not be surprised.

Q Yes?

A At the present rates of interest.

Q And that the pensions that will be paid by the country to those who have served in the Armed Forces and the rehabilitation programs which will be adopted, will involve heavy annual payments by our Government to an extent that was not even thought of or comprehended back in 1939?

A That is right.

Q Well now, what I am getting at is this, Mr. Hamilton, is it not therefore reasonable to assume that the rate of taxation will not be substantially or drastically reduced for several years?

A Oh, I look for quite a substantial tax reduction on the corporate taxation.

Q Yes, from the, - what they call the excss profits I am not including those in the standard tax, - leaving that aside, that by reason of the things that I have outlined you cannot expect taxation to be returned to pre-war levels for a great many years?

A Are you speaking of our corporate taxes or universal taxation?

Q All kinds of taxes?

A I think you are right there, but I do not believe that we can say that the levels will hold in each division, there is the corporate individual for example, I look for quite some change there.

Q Well then let us turn for a moment to corporate taxation and I am asking you to leave aside for the moment any new scheme that may be set up to re-vamp the whole corporate taxation scheme of the nature of introducing the English system in place of our present system. Leave that aside for the moment. I am suggesting that because of these things that I have outlined to you that corporate taxation is not likely to be reduced to prewar levels for a great number of years or if ever.

A I am asked to assume that there is no change in the general base of the corporate tax ?

Q Yes.

A And there will be no change in it ?

Q Aside from that, leaving that out of the proposition, well let me put it this way, Mr. Hamilton. We will assume first of all that the present general scheme of taxation is continued, that is the companies are taxed along the line they are now and the individual is taxed. Assuming that base that has existed from 1917 on is to exist in the future, I am suggesting to you that by reason of these extensive Government programs that it is extremely unlikely that corporate taxation will revert to the 1939 level ?

A My appreciation of the situation Mr. Chambers would incline me to believe that the tendency towards the elimination of double taxation will involve a gradual reduction of the corporate tax.

Q That is you are saying there is a possibility of the English system more or less being adopted in this country ?

A Without regard to what type of system, I think the tendency is away from double taxation.

Q And in the English system it is on the single tax ?

A I would not look for that being done overnight. I think the

tendency would be for a gradual reduction in the corporate tax so that the change-over could be effected without too much economic friction.

Q But if the double tax system is retained, would you agree with me that it is unlikely that the rate of that tax will not revert back to the 1939 level ?

A I think the tendency will be towards the reduction in the corporate tax with the view to either the elimination of double taxation or the minimizing of the effect of double taxation.

Q Mr. Hamilton, my question was if that system is retained, the double taxation system, -

A Well my answer to that Mr. Chambers is whether it is eliminated or not I am satisfied that the tendency will be to reduce the effect of it or to ameliorate the effect of double taxation.

Q Well then to the extent that it is eliminated then of course the tax will fall upon the individual ?

A That is right.

Q That is right. I would like to discuss with you for a moment, the difference between the basis of this double taxation system and the single taxation system. As I understand it, in England so far as the Income Tax Act is concerned, leaving out the Excess Profits Tax, they do not assess the company as such, but that the monies paid out to the shareholders by the company are subject to a deduction by way of tax prior to the receipt by the shareholder ?

A That is merely a matter of collection convenience. The incidence of the tax is on the shareholder at the time of receipt.

Q And the company is merely made the collecting agent ?

A That is right or at least that is my understanding of the

English tax situation.

Q And there are certain rules that tax cannot be avoided by the Company by arbitrarily holding the profits in the business and not paying it out ?

A There are certain safeguards.

Q And that is the basic difference between the English tax and ours where the company is taxed as such and what is left goes to the shareholders by way of dividends ?

A And is taxed again.

Q And is taxed again on the shareholder. You will agree with me in this I take it that over the next several years, say ten years, the Canadian over-all tax budget will not likely revert to the level of 1939 ?

A I do not expect it ever will. I think the national income is up sufficiently that proportionately it will be back to the 1939 level before very long.

Q Now what I am suggesting to you Mr. Hamilton, is this, that apart altogether from any inflationary tendency the outlook is for a permanent and gradual increase in after war costs over and above the 1943 costs ?

A The costs of what ?

Q The general price index throughout Canada.

A I do not know that that necessarily follows, sir.

Q But would you not go this far with me that it is a probability?

A Some things will of course increase in price and other things will probably decrease tremendously due to the technological advance which the war acted as a stimulus throughout a period of rising, for instance the price of Ford cars came down, besides which the quality improved. There will be, too, undoubtedly a different trend there to force the price of each down.

Q Don't you think the average post war income of labour will increase rather than decrease ?

A I believe it will.

Q And that the general standard of living will increase ?

A We hope so.

Q And what I am suggesting to you is that the general price level throughout Canada is not apt to decrease. First of all is not apt to decrease to the pre-war level ?

A The general level of prices. I am afraid that question is a bit beyond me Mr. Chambers. I can see that some prices are possibly going to stay up at war levels, but I am quite satisfied there are a great many others that will come down in terms of real value. What the effect on balance will be I would not hazard a guess.

Q Is it not true that after the first Great War that there never was a reduction back to the pre-war levels of 1913 ?

A I wonder to what extent the 1914 - 1918 experience of values is of us today.

Q But is that not a fact ?

MR. BLANCHARD: What particular prices are you speaking of ?

MR. CHAMBERS: The prices generally throughout Canada.

MR. BLANCHARD: Wages ?

MR. CHAMBERS: Wages and things that wages are expended on.

A Can I have your question again Mr. Chambers ?

Q MR. CHAMBERS: Is it not so that following the end of the first Great War that the general price levels in Canada never reverted back to the pre-war levels of 1913 ?

A They came close in 1922. I would not think, I have not got the tables before me, but I know they came down pretty drastically during the early middle twenties.

Q But my understanding is and I am putting it to you as a question. My understanding is that certainly they never went back to the 1913 level ?

A I do not think they did, no.

Q And in any event the wages did not ?

A Not in dollars per man hour, no. I am not saying that labour costs did not go back.

Q Well now is this not a fact that the only thing that would bring down prices to any great extent would be a period of deflation or depression ?

A Bringing them back - speaking now from 1945 ?

Q Yes.

A Bringing them back to what ?

Q 1939.

A I doubt if they would go back to 1939. That is general prices, sir.

Q Mr. Hamilton, I take it that you are familiar with, or at least have read Section 49 of the Natural Gas Utilities Act ?

A I have read it, but I am not very familiar with it.

Q In Section 49, sub-section (1) it says:

"The Board shall have power,-

(b) from time to time to appraise and value the property of any public utility whenever in the judgment of the Board it shall be necessary so to do, for the purpose of carrying out any of the provisions of this Act, and in making such valuation the Board may have access to and use any books," and so on,

and you will probably recall that there was a sub-section (2) of that section which says this:

(2) In fixing and determining prices or values of any real or personal property for any of the purposes of this Act the Board shall not be bound by the price paid by the owner or the replacement cost or by any book values however established by the owner for such property, but may adopt any basis or formula which to it shall appear just and reasonable, and in particular and without restricting the generality of the foregoing the Board in fixing such prices or values shall determine the just and reasonable allowance for depreciation and in so doing may take into account depreciation already taken by the owner or any antecedent owner of such property."

(Go to Page 3733)

Q Now I am suggesting to you, Mr. Hamilton, that the Board under that section is to proceed to make an appraisal or valuation and it is not bound to any one particular formula, but is given a discretion and nevertheless what the Board has to do is to arrive at a valuation or at an appraisal. Do you agree with me?

MR. BLANCHARD: Surely this witness is not called upon to interpret a section of the Act.

THE CHAIRMAN: No.

MR. BLANCHARD: Surely not.

THE CHAIRMAN: I do not think so, especially since it is a purely permissive section.

MR. CHAMBERS: I do not agree with that statement, with deference, sir. I may be wrong. But I am trying to get the understanding of this witness because he comes here and says "I am recommending a rate base,". Now I would like to know whether he is constructing that rate base on section 49. I will put that as a question.

THE CHAIRMAN: That is fair enough.

A I can answer "yes" to that.

Q MR. CHAMBERS: Yes and in your judgment the rate base which you have recommended falls within that section?

A Yes sir.

Q Have you read, Mr. Hamilton, the report of the McGillivray Commission that dealt with the Valley Pipe Line, that is originally.

A Yes sir. It is some time since and I do not recall it in detail. I have read it and studied it.

Q Have you read the commission under which that Board or Commission was set up?

A I cannot say that I have sir.

Q Well I would like first of all to inform you that I get the information from the Alberta Gazette of October 31st, 1938 at pages 1059 and following, where there is set forth the commission issued by the Provincial Government pursuant to the Public Inquiries' Act and that commission reads in part as follows: The first part says that they appoint Mr. Justice McGillivray and Mr. Lipsett and then I am quoting: "To make inquiry into the matters hereinafter mentioned and to report thereon to the Lieutenant-Governor-in-Council,

(1) declaring the matters hereinafter mentioned to be matters within the jurisdiction of the Legislative Assembly, and to be matters of public concern namely. . . . ." and

then they list various things and we come down to:

"(b) the cost of gathering, handling and transporting in Alberta of crude petroleum and oil, refined petroleum products without limiting the generality of the foregoing.

1. the rate charged for gathering, handling and transporting the crude petroleum by pipe line or otherwise from Turner Valley to Calgary in the said Province and/what the fair and equitable rate for such gathering, handling and transporting should be."

Then there are others about adequacy of the facilities and so on. Now I am reading that to you, Mr. Hamilton, as a background that you should have when I put one or two other questions to you. I am asking you to assume with me that the McGillivray Commission was acting under that Charter or authority. I am now going to read to you from pages 17 to 19 of the Final Report of the McGillivray Commission

on pipe line matters. I am asking you to assume that the report I am reading from is the report growing out of that Commission and this is what is said starting on page 17:

"It seems to us that we must first decide as to whether or not a fair present rate can be arrived at in the present circumstances without regard to present value. We have no hesitancy in saying that no matter how reached present value must be ascertained for rate-base purposes if a fair present rate is the aim of the rate-maker."

Now I am putting it to you as to whether or not you are in agreement with that statement.

A I wonder if I might have that read back to me. There is a question of a word or two that makes a difference to me.

Q It is the first paragraph there. (Report handed to witness.)

A Very good. I agree with that, "without regard to present value", yes.

Q And then the report goes on:

"Now, if prudent investment be assumed, original cost provides a figure not only of original value but of present value as well if there be no change in conditions or in price levels in the meantime but where as in this Inquiry there is reliable evidence as to original cost and as to present value which are entirely different and the difference is not accounted for by depreciation then it is to be assumed that there has been a change in conditions or in labor and material costs which accounts for the difference."

Would you agree with that statement?

A Substantially, yes.

Q And then the report goes on on page 18:

"One thing is certain, that if a rate-maker proposes to use present value in arriving at a rate-base neither

"original cost nor original investment will serve his purposes in the absence of evidence of unchanged conditions and of unchanged construction costs."

Would you agree with that statement?

A I would like to see it, sir.

Q The top paragraph.

A Not categorically, no.

Q Would you please explain to us your reason why?

A Perhaps you will permit me to have that?

Q Yes.

A I take it that the paragraph you put to me for assent was this:

"One thing is certain, that if a rate-maker proposes to use present value in arriving at a rate-base neither original cost nor original investment will serve his purposes in the absence of evidence of unchanged conditions and of unchanged construction costs."

I simply say I do not agree with that categorically.

Q I would like to have the benefit of your opinion as to why you do not agree with it.

A I think you have to take that particular paragraph in relation to its context. It is a little indefinite what is meant by for example, "present value".

Q I see. Thanks very much.

A I think the whole thing hinges on the substance to be taken from that word or term "present value".

Q Now I will go on with the next paragraph of the report:

"Our reasons for accepting the view that in the circumstances we must find present value for rate-base

"purposes may be shortly stated. In the first place we have the high authority of the Supreme Court of the United States for saying that in rate-making to be fair to the owner of the utility at least up to the point of avoiding confiscation present value must be taken into account."

THE CHAIRMAN: The Hope Natural Gas case was decided after that.

MR. CHAMBERS: Yes, but the Hope Natural Gas case was decided on a particular statate that was worded altogether differently from ours.

MR. FENERTY: But that is what you are going to decide this case on is the particular statute.

Q MR. CHAMBERS: Would you say this, Mr. Hamilton, that if present value is not taken into account in arriving at a rate base that the effect indirectly would be confiscation?

A No sir.

Q Why not?

A I believe that Reproduction Cost New or some other form of replacement value should be taken into account but I do not feel it should be taken into account to the exclusion of all other factors.

Q To what amount did you take it into consideration in your rate base?

A For consideration to see how closely the final answer approximated the answer that I arrived at.

Q That is the extent to which you took it into account excepting the 25 thousand dollar item?

A I weighed various factors and various phases in which the matter could be dealt with, to come to the conclusion at

which I arrived.

A And is it not so that Reproduction Cost figures are not reflected in your valuation at all except so far as the minor matters totalling about 25 thousand dollars?

A That is true. But applying the Reproduction Cost New and certain other factors and I arrived at a figure something similar within a very small margin of error. In, the summary statement WH la the report basis being the one predicated on Reproduction Cost New the gross value results in a net rate base of $1,623,542 and the particular basis which I recommend it is $1,573,668, a difference of approximately $50,000 which is in the order of 2/3 of the amount which you suggested to me of $76,000 and was so very small that it might be left out of account altogether.

Q As I understand it that figure of $1,623,542 is not Hill's figure after taking the $76,740 off.

A No but you put it to me a moment ago as to whether I took Reproduction Cost New into account at all and I said yes, I did, as a reconciliation.

Q Well not Reproduction Cost New, those are depreciated figures.

A Yes. But if the reporter would read back the particular question and answer I think you would see that what I have just said answers that. To make it clear, Mr. Chambers, I think the question put to me was "Well I take it you did not take Reproduction Cost New into account in arriving at your valuation".

Q That is right.

A And I said I dia take it into account although I did not adopt it.

Q I see.

A I took it into account in this respect, that the answer emanating upon that basis is almost the same answer as on the method which I did adopt.

Q And did the fact the figure of $1,623,542 was somewhere in the neighbourhood of the result that you arrived at lea' you to recommend that should be the rate base?

A No, that did not lead me to it but it inclined my judgment to some extent or influenced it.

Q Now let us revert to the report of the McGillivray Commission again. It goes on to say:

"We do not forget that the Supreme Court" - that is the Supreme Court of the United States - "has also said that original cost should be taken into account. As to this we think it enough to say that if present value is that which is sought and it appears that original cost and present value are different then original cost must be discarded on the ground that there can be no reconciliation of irreconcilables."

Would you agree with that statement?

A I would like to see it, sir. (Witness handed report.)

A Not altogether.

Q Well you qualify it by "not altogether". Would you please explain?

A I do not agree with it altogether. I might agree to it in principle taking it in regard to the context. It reads, the pertinent sentence:

"As to this we think it enough to say that if present value is that which is sought and it appears that original cost and present value

"are different then original cost must be discarded on the ground that there can be no reconciliation of irreconcilables."

On second thought I think probably I do agree with that.

Q But in fairness to you is this correct that you say that present value does not have to be sought in making a rate base?

A Pardon me, it is more syllogious than anything else at this point is it not? It reads: "if present value is sought and if original cost and present value are different then original cost must be discarded."

Q Yes.

A That is syllogious.

Q Am I right in this that you do not think that present value is to be sought?

A Well I would not say that, sir. I would say as to that second part it possibly does not follow "if it appears that original cost . . . . ." and so on.

Q Here is what the Commission says: "We think it enough to say that if present value is that which is sought. . . ", would you agree first of all in this case we are seeking what the present value is for the purpose of this rate base?

A Yes, subject to the clear understanding of what we mean by present value.

Q You admit in principle that present value is to be sought.

A Yes.

Q And is to be the aim of this Board in order to get a fair, just and equitable set-up?

A Well yes, but that is begging the question of what we mean

by present value. Present value for this purpose, I think, is what is meant.

(Go to page 3742)

Q Well now, then, I am suggesting to you the Commission, the McGillivray Commission says this:

> "that if present value is that which is sought and it appears that original cost and present value are different then original cost must be discarded on the ground that there can be no reconciliation of irreconcilables."

A I say that I agree with that first as syllogious but I do not exactly agree that it appears that original costs and present value are different. That is the assumption.

THE CHAIRMAN: And then does that question involve the assumption that present value means reproduction new less observed depreciation.

MR. CHAMBERS: No, I say this, and my suggestion is and I will put it this way, that the McGillivray Commission at least.....

THE CHAIRMAN: Mr. Chambers, perhaps I should not have interrupted.

MR. CHAMBERS: No, I think for the purposes of discussion it may be of help. The McGillivray Commission has at least said in its view that unless there is some evidence that the price levels are the same, the original cost and present value are not the same.

Q MR. CHAMBERS: Now, we will go on, Mr.Hamilton, then again:

> "it seems to us that the fact that the utlilties are now for the first time being brought under the control of a regulatory body on the recommendation of your Commissioners, is to be taken into account."

What do you say about that?

A I agree with that.

Q "It may be that in the future, a first rate-base being now determined, a regulatory body might well for the sake of simplicity and convenience dispense with engineering appraisals in further rate-making and adopt original cost methods treating the rate-base now arrived at as being original cost but this would be justifiable only because all capital additions and improvements would then be made with full knowledge on the part of the investors that the rate of return accorded to them would be in the discretion of the Public Utilities Board."

Are you in agreement with that?

A I am in agreement with it if you strike out the word "only" at the bottom of the first page, "justifiable only".

Q Yes.

"It seems to us that the present position is quite different. Here a utility which had enjoyed freedom from interference from any outside body is for the first time subjected to regulatory rates. In the case of future capital additions or improvements as stated the investment is made when the investor's eyes are open to how the return upon his money will be measured. In the case in which a utility is being regulated for the first time it is to be remembered that the capital already invested was invested prior to Government announcement of rate control."

Now, Mr.Hamilton, are you in agreement with that suggestion, that different considerations should apply when you are fixing the initial rate base of an undertaking brought under regulation for the first time, than

when you are dealing with a rate base of that same undertaking that has been under regulation for a period?

A I would say that the emphasis to be given to the various factors will differ under the two situations. They might not differ sufficiently to change the answer at all, but I believe your general proposition is sound that there are different situations and different emphasis to be placed on different factors.

Q Would you agree with the reasoning of the McGillivray Commission, which I just read to you, as to why that is so?

A The last excerpt?

Q Yes?

A Yes.

Q Well now, have you given effect to that reasoning or recommended rate-base?

A Given effect to or given consideration to?

Q Given effect to?

A Well that is rather a vague term, I have certainly given consideration to it, yes.

Q But have you given effect to it?

A I am not sure that I know what you mean by "given effect to it" I have taken it into consideration, yes.

Q Well what did you do after you gave it consideration, what changes did you make in view of that consideration?

A I did this, which I would not have done if this company had been in existence for the last 25 years, I added about a quarter of a million dollars to the historical cost with respect to items which had been expended and not capitalized, and yet

which I thought was probably included in the new rate base. If this company had been under regulation throughout, I would agree with the purport of that excerpt that those items should be excluded from the rate base, but I allowed them.

Q Yes, because if the Company had been under regulation the consumer would have furnished those extensions to the rate base?

A Quite right, sir, and I was going to say that I would not have advised the depreciation. If under regulation the rate base would have been the historical cost less the book depreciation, or say approximately eight hundred thousand dollars.

Q Now, Mr. Hamilton, I am going to refer you to further excerpts from the Judgment or Decision of the McGillivray Commission, and I am reading now from Pages 20 and 21:

"We may also point out that on the original cost basis if a utility is constructed during a high cost period the owner is entitled to collect a return upon original cost, notwithstanding a subsequent fall of the general price level. In other words, under the original cost doctrine which insures an investor a constant return upon his investment temporary high prices and high interest rates could be successfully projected into the future. On this theory all utility plant construction and additions would be made during peak price periods and the users would have to pay an annual charge for a service which could be reproduced for, perhaps, half the annual charge which they are called upon to endure. On the other hand, if a utility were constructed during a low cost period upon the original cost theory the investor would be prevented from

"earning a return on more than his original investment even though owing to changed conditions the plant had trebled in value and even though no substitute plant, if presently erected, could perform the service at anything like the rates prescribed on the original cost basis."

Now they go on:

"We think that the conclusion is inescapable; that at least in the case of Common Carriers presently brought under the control of a regulatory body, a present rate must be rested upon a rate-base which includes the present value of the physical properties."

Now that last statement, are you in agreement with that?

A Do you mean in its application to the present case or the case of which Mr. Justice McGillivray was speaking.

Q To the case he was speaking about?

A Not altogether, with deference.

Q Yes. Now why do you not agree with it, or you say "not altogether, with deference"?

A Well I believe that the question of original cost, full original costs include items which might have been capitalized and were not, less the accrued depreciable requirements gives you a bssis which is a satisfactory one in the very same way that replacement costs less observed depreciation gives you a basis which might be a satisfactory one. I have not read all the transcript of the evidence taken before the McGillivray Commission, and I have no doubt that they were inclined to that view because of their understanding and comprehension of the circumstances.

Q Then I have one more paragraph to read, Mr. Hamilton, from

this Report:

"In adopting this view we feel that we not only have the support of the Supreme Court of the United States but also at least the implied approval of the Judicial Committee of the Privy Council in the case International Railway Company vs. Niagara Parks Commission (1937) 3 All E.R. 181. "

And I understand your answer in effect to me is that even if that be so you do not altogether agree with it, is that a fair way to put it?

A I do not know whether that is so or not.

Q I mean with his reasoning?

A That is so. I am quite satisfied that it was applicable to that situation or may have been applicable to that situation but it does not necessarily follow that it is applicable to this present one, but you did not ask me that question, I am sorry.

Q I am glad you made it. In what respect do you think the situation here is different?

A Oh, in a great many respects, sir. In the first place there has been a substantial rise in the general level of prices since 1938 to 1943, and consequently there is a greater comparison between original costs and replacement value, that is the first point.

Q Yes, but my understanding was that there was a substantial increase of reproduction costs in 1939, of the Valley Pipe Line historical costs?

A There is certainly a further substantial increase between 1938 and 1943, which no one can dispute, which aggravated the situation. Now it might very well be that at a certain point

of the price curves it would be a matter of complete indifference which basis you used, further than the whole background of this present situation is different from what I understood to be the circumstances of the Valley Pipe Line. The Valley Pipe Line was a common carrier.

Q Then I refer you to Page 106, and it is really "Conclusion Number 10 of the Commission's Report:

> "For reasons which seem to us sufficient and which we have set forth at length we have come to the conclusion that at least in the case of an utility which is brought under the control of a regulatory body for the first time, it is only just and equitable that original cost should be discarded and that present value should be accepted for rate-base purposes."

Now as I take it, Mr. Hamilton, you do not agree with that situation so far as, - with that conclusion so far as the circumstances of this case are concerned?

A I would direct your attention to the opening phrase of the conclusion, it says "For reasons which seem sufficient to us" or something like that.

Q Yes, but what I am getting at, you say the reasons are not present in this case which would lead this Board to the conclusion, that is, that it is just and reasonable that the original cost should be discarded and that present values should be accepted for rate base purposes?

A Depending upon the construction placed on the term "original cost". I reject original cost if you mean the value prepared in the books. If you take the revised historical cost, I believe that would be proper.

Q THE CHAIRMAN: You might say it is the proper concept of present value?

A Yes.

Q MR. CHAMBERS: I think you told my friend, Mr. Blanchard, that so far as the question of the inclusion of the amount for materials and supplies in the working capital was concerned, that you had checked it with the Board's engineer?

A I got his over-all approval of the amount. He thought it was reasonable.

Q That was Mr. Biddison?

A Yes, Mr. Biddison.

Q Now you discussed the matter of rate base with Mr.Biddison?

A Yes, at some length.

Q And was it as a result of your discussions with him that you were led to adopt the rate base which you now recommend?

A As a result of .....

Q Yes?

A No. We had several discussions on the subject but I want to assure you that this is my opinion, not necessarily his.

Q No, but I am just asking it as a matter of interest?

A Yes.

Q Did not Mr.Biddison feel that some, that more weight should be given to reproduction cost than you have given to it in your rate base?

MR.BLANCHARD: Now that is not a proper question. That is hearsay evidence in cross-examination and it is not admissible. Surely he cannot go into that.

THE CHAIRMAN: I think it is going a little far afield.

MR. CHAMBERS: I am putting it as opinion evidence, and I say it is not unreasonable to ask that. Furthermore, he has done a certain amount of reading on this matter and I say that the discussions he has had with other parties and what he has read are relevant to test the value and the weight which should be given, to his opinion.

THE CHAIRMAN: He can be cross-examined to find out how he formed his opinion but I do not think you can ask him what Mr. Biddison told him, or what he did after that.

MR. CHAMBERS: Well I take it then that the witness is directed not to answer the question, is that right?

THE CHAIRMAN: Well I do not know, Mr. Chambers. I think you can ask him if he agreed with Mr. Biddison in his discussions.

MR. CHAMBERS: Well, I asked the question and I do not propose to withdraw it unless the Board so directs.

THE CHAIRMAN: What was the question again, Mr. Cutler?

REPORTER READING: "Q. Did not Mr. Biddison feel that some, that more weight should be given to reproduction cost than you have given to it in your rate base?"

WITNESS: It might save time if I would say that I do not know the answer to that.

THE CHAIRMAN: That is the answer then to your question.

MR.BLANCHARD: But there may be other questions of the same kind and I am not concerned really with what Mr. Biddison's opinion may have been but I am concerned in hearsay evidence being given here where the person who made the statement or statements is not here to qualify it or them.

THE CHAIRMAN: Of course we have had a good deal of it all the way through, but I think there is a limit. I do not know what Mr. Biddison's idea was.

MR. CHAMBERS: But I do suggest different considerations apply when you are testing the statement of an opinion witness.

THE CHAIRMAN: Well let us have your next question, Mr. Chambers.

WITNESS: I might be able to give you an answer if you re-phrase that somewhat.

MR. CHAMBERS: No, I will leave it as it is, I am satisfied with it.

A I do not know. He never saw this statement and this is a statement evolved in the last ten days, and I do not know what his opinion on it would be.

Q Did you discuss the pros and cons of the reproduction cost new as being the manner in which the rate base should be constructed in this case?

A Yes.

(Go to Page 3752)

Q And didn't Mr. Biddison think it should be -

THE CHAIRMAN: No, no, oh no. You can ask him what Mr. Biddison thought and if he expressed any opinion.

Q MR. CHAMBERS: Well did Mr. Biddison express any opinion in that regard ?

A In regard to the reproduction cost and rate base generally ?

Q Yes.

A Yes -

THE CHAIRMAN: What Mr. Chambers is trying to do is to get Mr. Biddison's evidence before the Board it is true.

MR. CHAMBERS: I am trying to find out how many people agree or disagree with the opinion of this witness.

MR. FENERTY: I want an opportunity of cross-examining this witness of Mr. Chambers that he has not got here.

MR. BLANCHARD: I might just as well ask Mr. Stevens-Guille what Mr. Trammell's opinion was or what he expressed about something. It is quite improper.

MR. CHAMBERS: Mr. Stevens-Guille was not called as an opinion witness.

MR. BLANCHARD: It does not matter, hearsay is not any more admissible on cross-examination than on direct examination.

A I think we are talking of reproduction costs now.

MR. CHAMBERS:

Q Yes.

A Yes he expressed an opinion.

Q As to that being included in the rate base ?

A Yes.

Q And you have not given effect to that opinion in your rate base ?

A Oh yes I have. Yes I have.

Q In what way ?

A Well in the first place Mr. Biddison and I both agreed -

MR. BLANCHARD: Just a minute. Probably you are quite willing to answer that but I object to any evidence being given that involves the opinion of Mr. Biddison whether favourable or unfavourable, or agrees or does not agree and I want a ruling on it.

THE CHAIRMAN: It is not proper cross-examination in my opinion.

MR. CHAMBERS: Is the question ruled out or not ?

THE CHAIRMAN: Oh yes, it is ruled out.

Q MR. CHAMBERS: Now Mr. Hamilton would you turn to Exhibit 125 which you filed yesterday.

THE CHAIRMAN: Are you starting something new Mr. Chambers?

MR. CHAMBERS: Yes.

THE CHAIRMAN: Then we might as well take time off now.

(At which time the Hearing adjourned for a short time)

Q MR. CHAMBERS: Mr. Hamilton, would you turn to Exhibit 125 please. Now on the second page you state as I understand it that the present prices are higher than the average for the construction period and that a valuation on the basis of present day prices would result in a capital gain accruing to Royalite. That is what in effect you say in the last to the second paragraph ?

A Yes sir.

Q And then you go on to say that is the sort of gain which in your view might reasonably be split between a willing buyer and a willing seller ?

A Yes sir.

Q Now have you given any effect to such a split in your

recommended rate base ?

A Yes sir.

Q How ?

A First of all, I think that we should pay some regard to the significance of the terms "willing buyer" and "willing seller" which are very vague terms and hard to apply. The term "willing" obviously being a relevant term. Anyone is a willing buyer if the price is right and anyone is a willing seller if the price is right and whether a person in a particular instance is a willing buyer depends upon the price at which the particular deal is offered to him at. A substantial gain does accrue to the Royalite under the proposal recommended by myself in that the depreciation reserve is substantially reduced. And secondly, in that some quarter of a million dollars in gross valuation which was expended has been reinstated as part of the historical cost. Both of those factors result in a very substantial gain to Royalite, of a capital nature.

Q No, but Mr. Hamilton, these items which you say you have included in historical costs which were not shown as part of the capital cost on Royalite books in essence are they not what the actual cost to Royalite were of those items ?

A Substantially yes.

Q What I am suggesting to you is that your rate base other than these items of $25,000.00 is really an original cost basis leaving out the question of depreciation ?

A The $225,000.00 you mean ?

Q No, the $25,000.00 that had to do with office furniture ?

A Oh no sir. I am speaking of the figure of approximately $225,000.00 or $250,000.00. Something of that order of cost which might perhaps have been properly capitalized by Royalite

had it chosen so to do, but which were not and the fact that it is now included or that it is being suggested it might properly be included in the gross valuation does result in a substantial capital gain to Royalite.

Q But what I am getting at is that amount of $225,000.00, a part of Royalite's original cost.

A I would say yes, but it still results in a capital gain.

Q But as I understand in what you state in the second paragraph on Page 2 is that if there is a substantial difference between the price levels at the date of construction and present price levels that that difference in price levels should be more or less split between the willing vendor and the willing purchaser. Now you have not done that in your rate base have you ?

A Perhaps I can assist in this respect.

Q Yes.

A I think we can put our finger upon three possible capital gains to Royalite. First of all is the restoration of items of costs which were expended. Second there is the reduction of the depreciation reserve and apart altogether from either one of those two there is a third possible capital gain in the sole factor appreciation and I would say that third type as well as the other two and that is the one to which you are now referring, the third type might be split between a willing buyer and a willing seller. Presupposing that your buyer is willing and that your seller is willing, both of which terms beg a question. I would assume from the course of cross-examination of at least two Counsels that there is much doubt as to whether they are willing buyers in regard to certain types of equipment and I take the tenor of Mr. Fenerty's cross-examination to mean that his clients do not want the gathering lines as a gift.

Q Leaving out of the picture for the moment the question of regulation or devotion to public service, let us discuss it from the standpoint of two private individuals. A willing vendor and a willing purchaser in a deal such as that you say it would be reasonable to expect that the willing vendor would probably get in his price approximately some split, approximately say half on this increase due to the increased price levels ?

A I would say that the capital gain represented by this particular factor of price level appreciation represents a margin of trading, the extent to which the two parties would participate in that margin would depend upon the relevant bargaining positions in an uncontrolled situation, and it might be split or it might all accrue to one or the other depending upon the relative bargaining power. It makes it just that easier for them to get together. May I put it that way.

Q And in your view both would probably end up with part each ?

A They might but not necessarily so. They might accrue in the total.

Q You say on Page 2 "in my view one might reasonably assume would be split somehow between a willing buyer and a willing seller."

A Yes sir. What I intended to convey by that statement was that it was that sort of gain which would not necessarily accrue in total to one or the other but it might accrue in total to one or the other without the interests of the other being prejudiced.

Q Now then on Page 3 of your Exhibit 125, the last paragraph. Am I right that you do not suggest or that you do not give Royalite or Madison the benefit of any such split because you assume Royalite was an unwilling vendor and they would not

have sold ?

A Can you direct my attention to the particular -

Q The last paragraph on Page 3.

A I am sorry my spacing is different.

Q It starts off, "As to the second question - that no part of the capital gain accrues to the Company. This is of course an objection from the Company's point of view and it rests on the thesis that the Company is denied a profit that it could otherwise have gained. I question whether this is so. There is nothing to suggest that Royalite would ever have sold this system now or at any time in the future".

A The general purport of those remarks sir was to convey the idea that was in my mind that the analogy to a willing buyer and a willing seller situation does not apply in this case. It is not an open market. You do not get a hammered out price for those assets. There is only one vendor and only one possible purchaser.

Q But you are assuming that Royalite was an unwilling vendor ?

A Not necessarily sir. It may be that Royalite could not find a willing purchaser.

Q I know, but what I am trying to get at is the significance of your remark,"there is nothing to suggest that Royalite ever would have sold its system now or at any time in the future".

A And your suggestion to me is that the inference of that is that Royalite would have been unwilling to sell ?

Q Yes.

A And I suggest there is a further inference that Royalite might not be able to find a buyer.

Q But the purport of this particular statement that I have just read to you, you do not think that Royalite would have wanted

to sell ?

A Not necessarily, not wanted to, but would not have sold for one of many reasons. They could not find someone to buy. Maybe could not afford to sell because they were under contract to sell gas and the system was an integral part of that deal.

Q Now Mr. Hamilton, the effect of legislation as I understand it is that this property which was in private control and private regulation before is by virtue of the Statute as it were, devoted to th public service ?

A Yes sir.

Q That is a common and usual term of these kinds of things ?

A Yes sir as long as you do not say dedicated.

Q There is another type of legislation that interferes with private property of individuals, what is called expropriation proceedings ?

A Yes sir.

Q Where the Government says in the public interests or for some other purposes a certain amount of property or piece of property that you own, we want to take that from you and there is provision in the Statute to enable them to do that and there is usually a Tribune set up to decide what the fair compensation is. That is right ?

A Yes sir.

Q Is it not usual in those cases for the Tribunals to allow something for what they call compulsory taking ?

A Yes sir,

Q Because they assume that the vendor or the party whose property is taken does not want to sell ?

A Or might not want to sell.

Q Your rate base does not give any effect to that ?

A Yes I think it does.

Q In what way ?

A Well for one thing there has been no obsolescence applied to the Seaboard plant. There has been no discount to the Seaboard plant for excess operating costs of the Seaboard. There has been no -

Q Pardon me ?

A There has been no special consideration given to a discounting of the gathering lines because of any possible excess impetus placed upon their construction in view of the absorption plant operation.

Q Is not the reason you did not give effect to obsolescence on the Seaboard plant that you took original costs rather than present day value or rather present day reconstruction costs. Put it that way.

A I say when you take historical costs you take the good and the bad. I want to go one step further Mr. Chambers. It is possibly my fault. It is not an expropriation proceeding. It is merely bringing an unregulated business into the field of regulated utility and different considerations will apply because the company continues in existence. Its property is not taken away from it and it still receives indirect benefits and may actually be improving its position by getting the safeguard of its rate of return through utility regulation.

(Go to Page 3760)

Q The fact remains that the right to use a piece of property has been abrogated by the legislation.

A It has been affected, I would not say abrogated.

Q So that we can do what we like with it?

A Well, within certain limits.

Q It is not a free use?

A No, I would say its rights have been limited but certainly not taken away entirely.

Q I think you said also, in Exhibit 125, in the first paragraph and also in the last paragraph that the plant now there probably would never be reproduced in the form in which we find it. Other than the Seaboard unit of the scrubbing plant my recollection of the evidence is to this effect that it would have been. Have you any particular evidence in mind on that?

A The inference I drew - inference, well, probably I should use a stronger term, the indication I received from the course of the evidence was that the gathering lines were substantially as they would have been had the utility business been operated as from 1943 or the lines placed in 1943 would have been substantially the same, not exactly the same. Different sizes of pipe might have been used and different distances traversed and so forth.

Q But substantially would be as it is now?

A It is a matter of engineering opinion, Mr. Chambers. And I would suppose that you might have constructed or placed in some other equipment and advantage would have been taken of the advance in technical studies to put in something perhaps a little more up-to-date in 1943 than might have been called for or available to the company at an earlier time. To what extent that would affect the

value I do not know.

Q Was not Mr. Hill's evidence and that also of Mr. Stevens-Guille to the effect it was up-to-date and the last word and so on?

A I take that to mean substantially up-to-date, that it was not seriously outmoded.

Q Mr. Hamilton, I would like to deal with the matter of depreciation, your existing depreciation or the amount of depreciation that has been deducted in arriving at the present rate base. Just for the purposes of the record and so that we may have it collected in one place - we went over it thoroughly yesterday - as I understand it, WH 4 contains the weighted percentage as to historical cost.

A Weighted percentage 27.33644 on historical cost without regard to salvage.

Q That is right. WH 5 is the weighted percentages of Reproduction Cost New.

A Again disregarding salvage the percentage is 27.98562.

Q And then WH 6 is the weighted percentages on historical cost.

A Of 25.71038. That calculation is based on certain salvage allowances.

Q Yes. WH 6, there are also additions for solution and transportation and general overhead.

A Yes sir.

Q WH 11 and 12 give the details by which you arrive at those percentages.

A By which we arrive at some of the parcentages, namely those applicable to gathering lines and compression systems.

Q Gathering lines and scrubbing costs.

A And compression systems.

Q And the compressor system?

A Yes.

Q WH 11 particularly deals with the depreciation on the basis of the wet gas gathered.

A Yes.

Q WH 12 deals with the depreciation on the basis of dry gas scrubbed.

A Yes sir.

Q And 13 to 20, well they deal with something else.

A I should also point out that these depreciation totals are yet to be varied when we have been given the definitive figures for the field reserve as of December 31st, 1943. But that will not change it very materially.

Q The depreciation on the boiler plant, electric plant and water station is dealt with in WH 4 and 6.

A Yes, sir.

Q And on page 5 of Volume 2 of your report?

A Yes, sir.

Q Now as I understand it, your method there, that is in connection with the boiler plant and the electric plant and the water station is to take the over-all age life in years first of all on the equipment.

A That would do it, yes.

Q And you assume that they had a total life of 30 years from the date of construction?

A Yes sir.

Q Now how do you reconcile that assumption with Hill's evidence that as at the Fall of 1943 these plants had a remaining life of some 25 to 30 years?

A I am also mindful of the evidence of Mr. Stevens-Guille on the same point which indicated that the, I believe it was the steam plant, was to receive substantial renovation in the period of the next 5 or 6 years.

Q I am instructed that what Mr. Stevens-Guille had reference to was only a portion of it and that Mr. Hill did take that into consideration and gave effect to it in his valuation in Exhibit 59.

A Perhaps I might say this, that it was expected that the gathering lines and the compression system and the scrubbing plant were in such physical condition that they in all probability would outlast the economic life of the field, whether that be 20 years, 25 years, 30 years or possibly even 35 years but that there was not the same assurance in the opinion of the Board's engineer with respect to such equipment as the steam plant and the electric plant and the water station.

Q In the opinion of whom?

A The Board's engineer.

Q In other words, what you have in your rate base is based on his recommendations rather than on the evidence that has been heard in that regard.

A This presentation, as you will recall it, was prepared in March before we had the evidence you speak of. Mind you, I do not know that it makes an awful lot of difference really whether you switch them to a combined wet and dry gas basis or leave them on the footing on which they now stand. I should perhaps add this observation that it seemed expedient and proper to insure that the steam plant and the electric plant which service outside companies

should be fully depreciated whilst these beneficiaries are still in the picture.

Q And you say that should affect present value?

A Yes sir.

Q For rate base purposes?

A Yes sir. The reason is the fact that they might have a capacity which is geared to present requirements but might eventually have a capacity far beyond the then-existing requirement.

Q In 1926 my fnformation is that there were additions to the steam plant made of the order of $10,700. Do you recall that?

A Not offhand, but I will accept it though.

Q You assume that that year's additions only have a life expectancy of to 1955, that is right is it not?

A 30 years from the date of installation.

Q So that would be 11 years from January 1st, 1944.

A That is right.

Q And my instructions are that in 1935 the additions to the steam plant were $26,200.

A I will accept that.

Q Then in regard to that you assume that portion of the plant only has a life expectancy to 1964 or 20 years.

A Yes sir.

Q I am also informed that in 1929 there were additions to the electric plant on the order of $54,500. 1929.

A I will assume that.

Q And that is about half of the total of about $110,000 for the entire installation.

A The electric plant?

Q Yes.

A Yes.

Q And for the purposes of your rate base you assumed that portion, that is about half the plant, only has a remaining life to 1958 or 15 years as against Hill's 25 to 30 years. Is that right?

A You take it year by year and the assumption follows because that is the process or the mechanics in arriving at the reserve requirement. On the other hand there must be borne in mind that the application of a formula such as that is in a sense imperial and its validity is to be judged more by the total over-all result that it gives rather than its precise application to a particular year's additions. Very much in the same manner that Mr. Hill for example justified the 9% overhead charge with respect to construction or the acquisition of trucks and cars. He said you have to take the 9% overall and not deal with it with regard to one particular item. In other words, the 30 years' formula is applicable on an over-all basis and may result in some inconsistences or even absurdities as applied to a specific item in a particular year.

Q I suggest, Mr. Hamilton, that those instances that I have given you in fact apply to each addition throughout these years, by taking your assumption that the life of this plant is a total of 30 years. The illustration I have given you is equally applicable for every year.

A Yes sir.

Q Now am I not right in this, that your assumption of the total 30 years wholly disregards past maintenance and improvements and also future maintenance and improvements?

A No sir. The 30-year rate was predicated on the assumption of a fair quality of maintenance policy. If it is to be assumed that maintenance is to be of a very low order then of course a substantially shorter life will be taken into account.

Q You, I think, told us that you had not examined these plants other than just to look at them generally.

A That is right, sir.

Q And that in arriving at your depreciation which has been deducted from the historical cost you did that wholly without any regard to the amount spent on maintenance in the past.

A No sir. I assumed from what I have been told that the plants had been maintained throughout in a reasonable state of repair, possibly even a superior state of repair.

Q How did you arrive at this period of 25 to 30 years?

A 30 years, as I say, was the figure suggested by the Board's engineer which did not appear to be unreasonable in the light of general practice and understanding.

Q Assuming for the moment that Mr. Hill's evidence is the only evidence that is put before this Board, and Mr.Stevens-Guille's, as to the ultimate life of these plants and if that evidence is to the effect that the life is longer than the 30 years, I take it you are prepared to adjust your figure on depreciation accordingly?

A Providing the life is not extended beyond the point where economic factors come into play.

Q What do you mean by that?

A We speak first of all with regard to the physical factors, depreciated due to wear and tear and the action of the elements. Then so long as those factors will operate to

retire the equipment before the economic death you might say of the investment, then they are the ruling factors. When the physical life will be projected beyond the economic life then the economic factors become the paramount consideration rather than the physical.

Q Yes, but assuming these plants will last the life of the field for the purpose of arriving at your factor for the deduction of depreciation, should not we take the years in which this plant would go out of operation due to the elimination of the field as the period remaining undepreciated?

A If the physical life can be expected to extend beyond the economic life of the field, I would suggest that we would substitute a throughput formula providing that proper consideration was paid to the relative capacity of the plants in relation to the services that they might be called upon to perform. In other words, I think we have to have regard to the beneficiaries other than the utility company proper.

Q And that the present day value or rate base should depend you say on the benefits that are going to be done by people using them in the future?

A No, I do not say that but I said that consideration will have to be given to that in another respect.

Q Assuming the evidence is that this plant will be there 35 or 40 years from now, I do not know, and will be used and useful, then would you . . . . . .

A I would use the throughput formula, a matter of engineering opinion as to which of the two considerations is paramount, the economic life or the physical life.

Q Now let us turn to gathering lines and compressor stations 1 and 3, on the matter of depreciation. Those are dealt

with, I take it, in WH 4 and 6 and page 5 of your report. For the purpose of estimating the existing depreciation of these properties, as I understand it, you deduct that proportion of the cost or value which the wet gas throughput prior to 1944 bears to the total over-all wet gas throughput year by year. Is that roughly . . . . .

A Provided that you take the wet gas throughput to date from the date of installation and not the total throughput. Take each year separately.

Q Yes. For the purpose of getting the effect for the existing depreciation to be deducted you take first of all the throughput until 1944, is that not right?

A In regard to each particular year from the mid-year of that year.

Q Oh yes. I remember that.

A Just to make it quite clear, the total throughput of the gathering system to December 31st, 1943 was 397 billion cubic feet.

Q That is right.

A Then the total effective throughput is 702.

Q That is right.

A Following that, it might be assumed that everything is depreciated at least half while nothing, except in the early years, has depreciated that heavily.

(Go to page 3769)

Q Depending on the installation of the particular equipment?

A That is right.

Q And for that purpose, as I understand it, assuming that the wet gas gathered to the end of 1943 was 397 billion?

A Yes.

Q And the wet gas to be gathered will be 304 billion?

A Yes.

Q Or a total of 701 or 702 billion?

A 702 billion.

Q Yes. Now then, if we take Dr. Katz' estimate, I suggest that the comparable figures would be the wet gas gathered to the end of 1943 would remain the same at 397 billion cubic feet, and that the wet gas to be gathered would be 395 billion cubic feet, and I get that figure from Summary "A" of Exhibit 47, have you checked that?

A No sir, I have a figure of 345 billion.

THE CHAIRMAN: Is that Dr. Katz' final report?

MR. CHAMBERS: Well it is the compilation which Mr. Stevens-Guille put together after Dr. Katz' report was put in.

WITNESS: Probably to shorten it, I would substitute whatever the Board finds to be the field reserve.

Q MR. CHAMBERS: Yes, that is so?

A That is all.

Q Assuming then for the moment that that figure which I have given you is the correct one,.....

A That it is higher than the 304 I have assumed?

Q That is 395 instead of 304?

A It would reduce the amount of depreciation accrued on all our throughput formulas.

Q THE CHAIRMAN: And thereby increase the final rate base, whichever it might be?

A Yes.

Q MR.CHAMBERS: To the extent that the future throughput is more than your 304 billion, there would be less depreciation come off?

A Yes, but the change would not be in direct proportion.

Q No, and the resulting rate base would be somewhat higher?

A It would be higher. It might be substantially higher too, by reason of the fact that, - well I do not think we need to pursue it, it could be changed materially.

Q Now, Mr. Hill, as I recall it, in Exhibit 59 says that the future use of the life of the gathering lines was 50 years or more, and the compressor station 40 years or more, that is if there was gas there to handle, that he figured they would be useful for that period, do you remember that?

A I remember the figures were longer than 25 years or 30 years.

Q Now do you recall this, and it is just my recollection, that the other evidence that has been put in here leads to the conclusion or indicates that the gathering lines and the compressor station will be used or useful until about 1974?

A Presupposing a certain rate of extraction, yes.

Q Yes. Now if that is the case why should not this deduction for existing depreciation on the service life basis be that proportion that the expired years bear to the total years of life, as an example of that I take this, say nine years old at the end of 1943 and the total life would then be 40 years, why should not the accrued depreciation be 9/40ths?

A In other words, why is not the proper factor the time element?

Q Yes?

A Rather than the volume element?

Q Yes?

A For this reason, sir, that these lines, I assume, were put in to

gather so much gas, not to be used for so many years, and they will equally furnish or serve the purpose for which they were installed if that gas was gathered in six months instead of being gathered in six years. The purpose of installing the lines is to gather so much gas.

Q Well assuming the lines have been in only three or four years and it handled all this gas, would you give the same deduction for depreciation?

A I say the time element is of no consideration whatsoever. The important consideration is volume, when you are in a situation where physical life extends beyond the economic life.

Q No, but assume with me that these lines had been put in within the last five years?

A Yes.

Q And they had been used to put the entire throughput through, the 397 billion?

A Yes.

Q You would then arrive at the same result?

A Yes.

Q That is you have now in your rate base on account of the existing depreciation or accrued depreciation.....

A They were put in to take that seven hundred billion feet, and if they have taken already through it one-half, then their value is half gone, that is assuming there is no salvage value attached to the line of any important amount.

Q I think you told me you had read the McGillivray Commission Report?

A Yes.

Q Did not the McGillivray Commission for the purposes of arriving at existing depreciation do it on a time basis?

A I believe they did.

Q And you disagree with that?

A Well.....

Q Let me put it this way, you think this is preferable?

A I think it is, sir, and I think it is the general consensus of opinion, Mr. Hill's opinion and the Company officials' opinions, that is any that I have heard or that were urged on me, and it is certainly my own opinion, and when I say "suggested by officials of the Company", I am speaking prospectively rather than retrospectively. We differ in that.

Q And do you suggest that the value or the amount of the present rate base should depend on the manner in which you are going to establish the depreciation in the future?

A Not necessarily, sir, no, but I say this that if it is the considered opinion that throughput is the proper formula for the company, that a considered opinion emanating from the same source will probably give you the same viewpoint there, with regard to its applicability in the past.

Q If the Board should decide that the future depreciation should be dealt with on an annual basis, would you also suggest that in that case the existing or accrued depreciation should be computed on a time basis rather than on a throughput?

A No sir.

Q You would not?

A No sir. Perhaps this would, might be helpful in coming to some appreciation of the principle involved. I think we must always differentiate between depreciation as a physical fact and the value that is placed upon it as an appreciated expense, the appreciated expense, the appreciation accrued

is a dollars and cents value to a physical fact, whereas, you may try to get it close but you certainly do not exactly hit the nail right on the head and from that you might choose to overstate or understate your appreciation expenses, as the Royalite have done.

Q So I understand if the Board should decide that future depreciation should be dealt with on an annual basis, you would still recommend that the depreciation up until 1944 should be computed on a throughput basis?

A Yes.

Q Probably I can put that question this way, that if the Board should decide to take care of depreciation for the future on an annual percentage basis, you would still recommend that the accrued depreciation up until 1944 would be computed on the throughput basis?

A Yes, because I cam visualize the Board's saying "Well we realize that the proper way to depreciate this would be on a throughput basis but as a concession to practicability we are going to do it on some different basis," but the fact that they chose to adopt such a treatment does not change the physical facts.

Q Well is this not so, Mr. Hamilton, in view of the evidence of Mr. Hill with respect to pipes that are used and useful to do the job which has to be done in the future, is not impaired by reason of the amount of the throughput put through in the past?

A That is true.

Q And that the proportion of the throughput in the past to the total throughput does not represent the actual physical depreciation in the equipment?

A Oh I agree with him.

Q Yes. Now dealing with the scrubbing plant, as I understand it.....

A Pardon me, when you say "physical depreciation" you were referring to wear and tear?

Q Yes, the actual condition of the pipe.

A The physical condition, yes.

Q Dealing now with depreciation on the scrubbing plant, that matter is, I understand it is dealt with in W-H-4 and 6 and Page 5 of your Report, and for the purposes of estimating the existing depreciation on the scrubbing plant you adopt that portion of the cost, historical or reproduction, which the dry gas throughput prior to 1944 bears to the over-all dry gas throughput year by year?

A Year by year, yes.

Q And you estimate the total effective dry gas throughput in W-H-12 at 490 billion cubic feet, I think that is on Page W-H-12?

A Yes.

Q And that is made up as follows:

To the end of 1943 there is 153 billion, and for the future 336 billion, which gives us a total of 489 billion; now then on the basis of Dr. Katz' recommendation my understanding is that that would come to 514, and here is how I arrive at it: To the end of 1943 we have the same figure of 153 billion and then for the future the figure is 361 billion, and I get that on Pages 1 and 2 of Exhibit 47, which was the resume by Mr. Stevens-Guille of all the Reports, but assuming that was so, then that figure of yours of 490 would become 514?

A Yes.

Q And the same remarks apply to this as we talked about on the wet gas gathering system?

A Yes.

Q Now I suppose, first of all will you say this, do you recall that Mr. Hill gave the scrubbing plant a used and useful life of 25 or 30 years, do you recall that?

A I do not but I will assume it.

Q Yes, and I take it that your reasons for estimating the accrued depreciation on the scrubbing plant are based on the same reasons which you gave us about the gathering lines.

A Yes, substantially that the investment is made to put through a certain quantity of gas. We assume that the salvage value is negligible and the value cannot be recovered except through production, therefore the measure of its value at any time is the unexpired portion of the service life made in terms of volumes.

Q Now on W-H-5 which deals with the reconstruction costs new, it is $742,173.55, and you deduct for depreciation on the throughput basis $149,162.71, which would leave the rate base at $593,010.84 on that basis?

A Yes.

Q Whereas Hill says that the value of the scrubbing plant on a reconstruction cost new basis is $541,000.00, and he suggests that $541,000.00.....

A Pardon me, Mr. Hill's comparable figure would be $534,720.46, would it not; the classification of the scrubbing plant in Hill's and in historical is not identical.

Q Oh, I see, well I will read probably.....

A The figures are not exact.

Q Well I have heard that Hill said its value was $685,712.00

and then you add the 9% overhead of $61,714.00 and you come up with $747,426.00, which was only five thousand more than you have?

A Yes.

Q In W-H-5?

A Yes.

Q Then Hill gave the depreciated value of $497,068.00 and adding 9% to that or $4,736.00, you get Hill's figure of $541,804.00, and that observed depreciation is therefore $205,622.00 as against your depreciation of $149,162.00, in other words there is a difference of $66,460.00, and then in addition to that Mr. Hill inferentially approved of a further deduction of $80,000.00, $83,000.00.

(Go to Page 3777).

Q Now what I am suggesting Mr. Hamilton is this, that those two methods applied to that scrubbing plant illustrate the effect of your method which wholly ignores the maintenance and the nature and condition of the asset itself which is being appraised or included in the rate base. Is that not so ?

A No sir.

Q Well how else can you account for that difference ?

A What difference ?

Q Mr. Hill has depreciated this property considerably more than you have because he has had regard to the condition of the plant and its usefulness ?

A Oh no sir, my eventual depreciation of the scrubbing plant will be below Hill's when you take Statement WH 5-A.

Q No, but what I am referring to is the amount you have got included in your rate base ?

A Oh yes, but my rate base - you mean on the adjusted historical cost, oh yes. That might be so. In other words to use the throughput formula does not necessarily operate against the Utility Company on every point.

Q What I am suggesting Mr. Hamilton is this, that what you are doing in estimating or computing your accrued depreciation is really a system of depreciation accounting rather than a valuation or appraisal of the property ?

A Well there never should be a depreciation accounting which is unrelated to facts. After all accounting is merely an attempt of reducing to dollars and cents values, dollars and cents expression to the effects of transactions and changes in value. You cannot disassociate it from engineering facts altogether.

Q No, but you have taken the cost of the property and it is now going to change hands or go into a new situation as a result

of which the present day rate base must be ascertained and what you have done in computing your accrued depreciation is really a cut-off of the over-all rate of investment ?

A Yes sir.

Q And that is done without regard to the condition of the property itself ?

A Oh no sir, it presupposes that the plant is in condition -

Q To last -

A To last the field and once it is of that degree of excellence anything beyond that is super-abundant. With particular regard to this matter of the scrubbing plant I think perhaps there are two observations which might tend to explain the apparent discrepancy there in the fact that Hill's valuation is higher than mine. The first is that by reason of the introduction of the additional volume of gas in the south end of the field there is an accretion to the estimated field reserve which tends to reduce the flow of through-put depreciation and secondly is the fact that I understood the force of Mr. Hill's evidence to be that he had applied some obsolescence factor against the Seaboard, some. These two factors taken into account go a long way towards explaining that apparent discrepancy.

Q In the case of a willing buyer and a willing vendor, is not the willing buyer more concerned in buying and sizing up what he is buying than what he should pay for it, with the ability of the plant to handle the job that he wants to do rather than what it has done in the past.

A In a sense sir, but it is also true that you do not buy a Rolls Royce to deliver potatoes in. In other words you make sure you do not invest more in a plant than is worth while from the viewpoint of what you can get out of it.

Q No, but talking about a gas gathering system or scrubbing plant. A willing purchaser, is he not primarily concerned as to the condition of the plant with a view to its being able to do a certain job for the future after he buys it ?

A That is right.

Q And he is not much concerned with whether there were ten million or twenty billion cubic feet gone through the system, is he ?

A Quite right, he is concerned with how much gas there is yet to go through.

Q Quite. That is the job to be done.

A That is right.

Q And what I am suggesting to you Mr. Hamilton is that the job to be done and the capacity of the plant to do that job and the amount of maintenance that has to be put on it is the thing that affects its value ?

A Absolutely provided that I accept your assumption that it is a situation between a willing buyer and a willing seller of equal degrees of willingness.

Q I am going to read you a short extract from the Accounting Research Bulletin issued by the Committee on Accounting Procedure, American Institute of Accountants, report to the Committee on terminology, No. 20, dated November 1943 and the appendix says this, heading Depreciation Accounting:

> "The depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation not of valuation".

Now as a layman, Mr. Hamilton, it suggests to me that is what

you have done for the purpose of arriving at the amount of depreciation to be deducted in arriving at a rate base ?

A That I have done what ?

Q It is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets over the estimated useful life of the unit(which may be a group of assets) in a systematic and rational manner.

A If you underline the word "rational" I agree with that definition whole heartedly.

Q Now it goes on to state that doing that it is a process of allocation not of valuation ?

A A process of allocation, right.

Q But not of valuation. Do you agree with that ?

A Could I see that again sir. (Bulletin is handed to witness) Yes sir, I agree with that.

Q In other words what you have done there for the purpose of computing your accrued depreciation is merely to allocate the capital costs between the vendor or I should say between the owner in private ownership and the owner in public regulation on the basis of the throughput ?

A Substantially yes and with particular reference to this definition of depreciation accounting. I think you can identify that depreciation accounting that is spoken of there with the process that was actually adopted by Royalite. That was a system of accounting for depreciation. My rate base determinations are not a system of accounting for they are an application of depreciation principles to a valuation situation but not in any sense a system of accounting. What went through the books for a period of fifteen years was a system of accounting and certainly did not result in valuation. It resulted in

a process of allocation.

Q And you have adopted that process of allocation for the purpose of arriving at your rate base ?

A Not the process that Royalite have done.

Q No, no.

A They are different allocations, yes.

Q And as I understand it your view is that this Board can arrive at a proper rate base without an inspection or appraisal of the physical plant ?

A No sir, I do not go that far. I say this to make it perfectly clear, that you must first satisfy yourselves that the physical life will extend beyond the economic life, assuming that it will. Assuming that the investment has been committed to that enterprise and cannot be removed. Assuming further that there is a negligible salvage value. On the basis of those three assumptions, the only allocation of the cost of that plant between pre and post regulation periods is one of through-put accounting, or through-put formula.

Q Well then as I take it from your last answer you would say that the only inspection or engineering advice that the Board would need would be such as would satisfy them that the plant will be there to do the job as long as there is any gas to be handled ?

A With reasonable efficiency and has not been unduly outmoded.

Q And that for the purpose of fixing the rate base they do not need an appraisal on reconstruction cost new basis by any engineers of the plant. Is that not right ?

A Oh no sir, I still admit and can see quite freely that the reconstruction value new and less observed value and a host of other approaches are valuable but are not necessarily the

final basis that will be adopted.

Q The rate base that you are recommending to the Board has been arrived at I suggest to you solely on the book costs of the plant less the deductions based on throughput. Is that not right ?

A No sir, plus the reinstatement of a substantial value for costs which were incurred and expense.

Q But you were satisfied from Royalite's books that that money was spent and charged to expense ?

A I was satisfied something happened within that but I am not suggesting nor have I ever done so, Mr. Chambers, that in approaching a rate base proposition from the different sides that you would say I will adopt this rate base and this base only and that is the only set of circumstances into which I will enquire. I certainly think it very useful to have the reconstruction costs worked out, the observed depreciation estimated by competent authorities and various other factors enquired into. I believe it is the duty of the Board to enquire into these various phases.

Q And I take it you looked into these other reports before you made your recommendation ?

A Quite and listened to the evidence.

Q But that after doing that you come along and bearing in mind I am not questioning your bona fides and you suggest in your judgment the reconstruction cost now should be disregarded and that they should take the straight historical cost ?

A Yes sir.

Q And that historical cost should be reduced in proportion that the throughput in the past bears to the total estimated throughput to pass in the future ?

A Yes sir and the principle reasons for it as opposed to reconstruction costs less observed depreciation is that I do not believe that the condition of the willing buyer and the willing seller can be said to exist in the premises. In other words this system does not constitute a marketable commodity.

Q And the reason that situation does not exist is because the Statute has intervened ?

A Not necessarily. It is a one time investment. You cannot pick it up and move it to some other place.

Q But you do not think if there had been no legislation that if Royalite wanted to they could probably have sold out ?

A Yes sir.

Q And they would have a willing buyer ?

A As I pointed out before the terms of willing buyer and willing seller is relevant. If the price is right they will buy and if the price is not right they would not. I can perhaps enlarge upon it to this extent with regard to automotive equipment for example. You have a truck and it is separable from the main enterprise. You can drive from Calgary to Edmonton and it has a marketable value and it has a price that can be hammered out to various groups of buyers and sellers but you have no such thing here. You have an investment committed to the extraction and processing of gas and it has no value for any other circumstances nor any other conditions. The only way that investment can ever be recouped is through the performance of the function for which the capital was originally invested.

Q Then do I understand you Mr. Hamilton, that your recommendation is as to historical costs being the basis for a rate base, would apply not only to this particular circumstance but to any utility being brought under regulation for the first time.

A Not necessarily, generalization is pretty difficult to meet.

Q But I gather one of your main reasons for saying historical costs should be taken and accrued depreciation is that there does not exist by the very nature of the operation the situation of the willing buyer and a willing seller ?

A That is right.

Q Is that not applicable practically to all utilities ?

A No I would not think so. You have one factor which is a wasting asset, a subject matter of transportation. Secondly you have that it is disregarding its corporate boundary, it always has been an integral part of Royalite operation. I doubt now whether it is totally separable.

Q Is it fair to say this that one of the main reasons why you are recommending historical costs is because the operation has a limited life ?

A It is the reason why I reject observed depreciation, yes sir.

Q Is that also the reason why you take the historical costs rather than reproduction costs.

A Oh there are a variety of reasons. On the matter of actually improving its position by safeguarding what its rate of return should be through utility operation.

(Go to Page 3785)

A Not the least of which is if you take Reproduction Cost on one basis of depreciation you come to a figure that is substantially the same. That has a good deal of weight in my opinion.

Q Now we have talked a lot about depreciation. Would you agree with me in this definition that it is " loss not restored by current maintenance."

A I think I am going to. Is that the end of your definition?

Q I am asking you if you agree with that.

A It is loss . . . . .

Q Not restored by current maintenance.

A That is altogether too terse a definition. It does not cover many things. I thought you were going to read me the N.R.C. definition.

Q Well that is one I am putting to you.

A I cannot accept it on that short wording.

Q THE CHAIRMAN: Loss in value, loss in service. Are those the words you want?

A Well it is a lengthy definition out of, I believe, the same pamphlet. It starts off that way.

Q MR. CHAMBERS: I am reading from The American Society of Civil Engineers "Principles of Depreciation", published November 1944, bottom of page 1365. "Broadly speaking, depreciation is the loss not restored by current maintenance which is due to all the factors causing ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy and obsolescence. Annual depreciation is the loss which takes place in a year."

A Yes sir.

Q Do you agree with that?

A Yes sir.

Q Now then what do you understand by the term observed depreciation?

A I take it to be a term used by engineers to denote the degree of impairment of the physical quality or quantity of the asset.

Q I notice that in the Accounting Terminology, a publication prepared by the committee on accounting terminology of the Dominion Association of Chartered Accountants, at page 26 they define depreciation as "the diminution in service or physical value of an asset caused by wear and tear, wind and weather, age, obsolescence, etc."

A Does it say etcetera?

Q Yes. I am suggesting that the word etcetera is relative to the words already used.

A Adjustem generis, eh?

Q Do you agree with that definition?

A Yes.

Q Now you have not told me yet though what you understand by the term "observed depreciation". I am sorry, you did.

A Oh yes.

Q That is right. I am suggesting to you, Mr. Hamilton, that accrued or existing depreciation based merely on the proportion of the total over-all service life on a throughput basis that has expired, first of all disregards past improvements to and maintenance of property that has in the past been charged to expense, is that not right?

A I reiterate that I am assuming a reasonable quality of maintenance. Not necessarily an extraordinary degree of excellence. A reasonable quality of maintenance.

Q And if the property was maintained better than average?

A Yes.

Q Your submission would not give effect to it?

A I do not think it should, sir, for the simple reason you are no doubt aware as Mr. Hatfield, a very imminent accountant once said, "all machinery is on an irresistible march to the junk heap". No matter how excellent a shape of repair you keep these assets in, there comes a day when they cease to have any economic value at all, although there may be lots of pipe there in excellent condition, properly wrapped and so forth but it has not any economic value.

Q Is it not a fact in an operation that is still going to have an estimated 25 years, that the better the state of maintenance of the plant at the moment would result in less maintenance for the future?

A Yes sir. There would be fewer retirements, which would be one of the considerations which inclined Mr. Hill to the view that substantially the plant would last to maturity. If maintenance had not been excellent, I assume there would be parts of the plant which would not last out the economic life.

Q Now then supposing this situation takes place, that considerable amounts of betterments, we will say, have been charged to capital in the books rather than expense, the historical cost would be greater would it not in that case? The historical cost now would be greater.

A If there had been betterments that were expensed.

Q No that had been put into capital rather than expense.

A Oh you mean if there had been betterments which were expensed and they had been capitalized instead of being

expensed.

Q Yes.

A Yes, it follows.

Q So that the resulting figure that you have now got depends to a certain extent upon whether certain items in the past had been charged to expense or put in the capital account.

A Yes sir. You will recall our submission, sir, though that we have satisfied ourselves that substantially the assets covered by the appraisal and the assets covered by the historical cost are the same.

MR. CHAMBERS: If the Board pleases, I cannot finish today and I have been on my feet since 9.30. I would suggest an adjournment.

THE CHAIRMAN: It suits me very well because I have to leave for Cardston very shortly and the extra 15 minutes will be very valuable to me.

(At this stage, the Hearing was adjourned until 9.30 A.M. 5th November, 1945.)

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